

Message Text

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FM AMEMBASSY PARIS

TO SECSTATE WASHDC PRIORITY 5588

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PASS TREASURY FOR WIDMAN FROM MCGREW

E.O. 11652: N/A

TAGS: EFIN, FR

SUBJECT: FOLLOWING OUR ASSESSMENT OF FRENCH ECONOMIC
PROSPECTS FOR COMING YEAR, AS REQUESTED LISTER-MARK
TELECON DECEMBER 12

1. SUMMARY. GOVERNMENT'S PROGRAM FOR COOLING OFF
FRENCH ECONOMY HAS PRODUCED ITS FIRST RESULTS: PRICE
INFLATION WAS DOWN TO 12 PERCENT ANNUAL RATE IN LAST
QUARTER OF 1974, AND TENDENCY FOR FOREIGN TRADE DEFICIT
TO WORSEN HAS BEEN ARRESTED, THANKS PRIMARILY TO SLOWING
OF IMPORTS. COST OF THESE ACCOMPLISHMENTS HAS BEEN
DECELERATION OF GROWTH RATE TO 3.5 PERCENT RANGE AND
RISE IN RATE OF UNEMPLOYMENT TO 3.2 PERCENT, A POST-WAR
RECORD FOR FRANCE. WE PROJECT CONTINUATION AND INTENSI-
FICATION OF THESE TRENDS IN 1975, WITH REAL GROWTH AT
ABOUT 3 PERCENT, UNEMPLOYMENT CLIMBING TO 4 PERCENT,
RISE OF CONSUMER PRICES FROM BEGINNING TO END OF YEAR
AMOUNTING TO SOME 10 OR 11 PERCENT, AND BALANCE OF PAY-
MENTS SHOWING CURRENT ACCOUNT DEFICIT OF NEARLY \$6 BIL-
LION, DESPITE NOTABLE SHRINKAGE OF TRADE DEFICIT IN

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LATTER PART OF YEAR. GOVERNMENT'S STABILIZATION POLICIES

ARE MATTER OF MUCH PUBLIC CONTROVERSY, PRECISELY BECAUSE OF PINCH THEY ARE IMPOSING IN TERMS OF LOWER ECONOMIC GROWTH, REDUCED CAPITAL SPENDING AND MORE FRENCHMEN OUT OF WORK. SO FAR, HOWEVER, GOVERNMENT HAS STOOD ITS GROUND. DESPITE POSSIBILITY THAT PRESSURES FOR EARLY LOOSENING OF STABILIZATION RESTRAINTS COULD PROVE IRRESISTIBLE, THERE IS NOT LIKELY TO BE MAJOR SHIFT IN ORIENTATION OF GOVERNMENT'S ECONOMIC POLICY BEFORE MIDDLE OF YEAR. WITH THIS TIMING, SUCH A SHIFT WOULD PROBABLY NOT HAVE MUCH EFFECT ON 1975 ECONOMIC OUTLOOK WE HAVE PROJECTED. END SUMMARY.

2. GROWTH. COOLING OFF OF FRENCH ECONOMY, WHICH GOVERNMENT ADDRESSED IN ITS STABILIZATION PLAN OF LAST JUNE, HAS PROCEEDED AT FASTER PACE THAN MOST OBSERVERS ANTICIPATED. THUS, WE ESTIMATE THAT IN SECOND HALF OF 1974 REAL RATE OF GROWTH OF FRENCH GNP WILL BE DOWN TO ABOUT 3.6 PERCENT (SEASONALLY ADJUSTED ANNUAL RATE) FROM 4.4 PERCENT IN FIRST HALF OF YEAR AND 6 PERCENT IN 1973. MAJOR WEAK SPOTS HAVE BEEN OUTPUT OF PETROLEUM PRODUCTS (DOWN 13.5 PERCENT IN YEAR ENDING SEPTEMBER 1974), PRODUCTION OF AUTOMOBILES (DOWN 13.7 PERCENT IN SAME PERIOD) AND CONSTRUCTION (VIRTUAL STAGNATION). OVERALL OUTPUT OF FARM PRODUCTS HAS ALSO BEEN FLAT IN 1974 WITH VALUE ADDED BY THE AGRICULTURAL SECTOR UP ONLY ABOUT ONE PERCENT OVER 1973 (WHICH WAS, HOWEVER, A RECORD CROP YEAR).

PROSPECTS ARE FOR FURTHER DECELERATION OF GROWTH RATE IN 1975. MAJOR FACTOR BEHIND THIS SLOWDOWN WILL BE ENDING OF INVESTMENT BOOM THAT SUBSISTED FROM 1971 THROUGH FIRST HALF OF 1974 (AT ANNUAL RATE OF BETWEEN 6.5 AND 7.5 PERCENT IN REAL TERMS). EXPENDITURES OF FRENCH BUSINESS ON PLANT AND EQUIPMENT ARE ALREADY FLAGGING UNDER COMBINED INFLUENCE OF LESS FAVORABLE BUSINESS CLIMATE AND GOVERNMENT'S STABILIZATION MEASURES, WHICH WERE SPECIFICALLY DESIGNED TO CUT INTO WHAT AUTHORITIES REGARDED AS EXCESSIVE RATE OF INVESTMENT. AN ADDITIONAL FACTOR LEADING TO CURTAILMENT OF INVESTMENT OUTLAYS HAS BEEN FINANCIAL SQUEEZE ON FARM SECTOR, LIMITED OFFICIAL USE

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RESULTING FROM RELATIVELY POOR CROP RESULTS IN 1974 AND ADVERSE MOVEMENT OF SOME PRODUCER PRICES. THESE TRENDS WILL GATHER MOMENTUM IN 1975. LIKewise SOARING BUILDING COSTS AND HIGH PRICE OF MORTGAGE MONEY (CURRENTLY 18-20 PERCENT) WILL CONTINUE TO DEPRESS DEMAND FOR HOUSING. SUPPORT FOR ECONOMY WILL COME PRIMARILY FROM CONSUMER DEMAND, WHICH, OUTSIDE AUTOMOBILE AND ENERGY SECTORS, SHOULD HOLD UP MORE OR LESS. ASSUMING A

PICK-UP OF BUSINESS CONDITIONS AMONG AT LEAST SOME OF
FRANCE'S MAJOR TRADING PARTNERS - GERMANY COMES FIRST
TO MIND - EXPORT DEMAND CAN ALSO BE CHALKED UP AS A
MODERATELY POSITIVE ELEMENT. ON BALANCE WE PROJECT
FRENCH ECONOMY TO COAST ALONG AT 3 PERCENT RATE OF

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PASS TREASURY FOR WIDMAN FROM MCGREW

GROWTH THROUGHOUT COMING YEAR, COMPARED TO ABOUT 4 PER-
CENT IN 1974 AND ANNUAL AVERAGE OF 6 PERCENT FOR FIVE
PRECEDING YEARS BACK TO 1969.

FRENCH GNP AT MARKET PRICES
(PERCENTAGE CHANGES IN VOLUME AT
SEASONALLY ADJUSTED ANNUAL RATE)

FROM PREV. YEAR		FROM PREVIOUS HALF-YEAR			
1973	1974	1975	1973	1974	1975
			II	I	II

6.0	4.1	3.3	3.8	4.4	3.6	3.2	3.3
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3. UNEMPLOYMENT. AFTER REMAINING AT ESTIMATED 2.3-2.4 PERCENT OF LABOR FORCE DURING FIRST EIGHT MONTHS OF 1974, SEASONALLY ADJUSTED UNEMPLOYMENT BEGAN TO RISE IN SEPTEMBER, MOVING UP TO 2.6 PERCENT IN THAT MONTH, TO 2.9 PERCENT IN OCTOBER AND TO 3.2 PERCENT IN NOVEMBER. THIS LAST FIGURE REPRESENTS BY FAR HIGHEST LEVEL REGISTERED SINCE END OF WORLD WAR II. UNQUESTIONABLY, LIMITED OFFICIAL USE

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DETERIORATION OF EMPLOYMENT PICTURE DURING FALL WAS CONSEQUENCE OF GENERAL SLOWING OF BUSINESS ACTIVITY, EXACERBATED IN INDUSTRIES LIKE AUTOMOBILES AND BUILDING WHERE PINCH WAS HARDEST. WITH FURTHER DECELERATION OF GROWTH IN PROSPECT, THERE IS LITTLE DOUBT THAT UNEMPLOYMENT WILL CONTINUE TO GROW IN 1975. PROBABLY IT WILL REACH SEASONALLY ADJUSTED RATE OF ABOUT 4 PERCENT BY END OF WINTER AND HOVER AROUND THAT LEVEL THROUGHOUT MOST, IF NOT ALL, OF THE REMAINDER OF YEAR.

4. PRICES. ON BASIS OF RESULTS FOR FIRST ELEVEN MONTHS, IT IS NOW VIRTUALLY CERTAIN THAT CONSUMER PRICE INDEX WILL RECORD INCREASE OF ABOUT 15 PERCENT FROM BEGINNING TO END OF 1974. DURING FINAL QUARTER ANNUAL RATE OF INCREASE WAS PROBABLY ABOUT 12 PERCENT, WHICH MEETS FIRST OBJECTIVE THAT GOVERNMENT SET FOR ITSELF IN PRICE FIELD LAST JUNE. THIS RESULT IS DUE TO WORKINGS OF GOVERNMENT'S STABILIZATION PROGRAM, COMPLEMENTED BY SUCH FAVORABLE DEVELOPMENTS AS DECLINE IN WORLD PRICES FOR A NUMBER OF THE PRIMARY PRODUCTS IMPORTED BY FRANCE AND STRENGTHENING OF FOREIGN EXCHANGE VALUE OF FRANC DURING LATTER HALF OF 1974.

OUTLOOK FOR 1975 IS NOT PROMISING, HOWEVER. IT HAS JUST BEEN ANNOUNCED THAT HOURLY WAGE RATES ROSE AT ANNUAL PACE OF 15.6 PERCENT DURING THIRD QUARTER OF 1974. WHILE THIS RESULT IS DOWN FROM NEAR RECORD FIGURES FOR TWO PRECEDING QUARTERS (MORE THAN 20 PERCENT IN FIRST QUARTER AND MORE THAN 24 PERCENT IN THE SECOND), IT REPRESENTS NO IMPROVEMENT ON THE UNSATISFACTORY 1973 PERFORMANCE. IN THAT YEAR HOURLY WAGE RATES CLIMBED BY ABOUT 16 PERCENT, A RISE WHICH UNDOUBTEDLY EXERTED HEAVY PRESSURE ON COSTS AND CONTRIBUTED TO ACCELERATION OF CONSUMER PRICE INCREASES THAT BEGAN IN FALL OF 1973. PERHAPS SOFTENING LABOR MARKET, EFFECTS OF CREDIT SQUEEZE ON BARGAINING ATTITUDES OF EMPLOYERS AND WORKING OF ANTI-INFLATIONARY LEVY WILL PRODUCE FURTHER MODERATION OF WAGE TRENDS. CERTAINLY SUCH AN EVOLUTION IS ESSENTIAL IF PRICE INFLATION IS TO RECEDE SIGNIFICANTLY BELOW PRESENT 12 PERCENT ANNUAL RATE.

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RESULTS FOR THREE MOST RECENT MONTHS AVAILABLE (SEPTEMBER-OCTOBER-NOVEMBER) SHOW CONSUMER PRICES OF MANUFACTURED GOODS AND SERVICES BOTH CONTINUING TO RISE AT ANNUAL RATE OF 15 PERCENT. THIS LACKLUST PERFORMANCE REPRESENTS REALLY NO IMPROVEMENT OVER THE PRECEDING THREE MONTHS, AND DOES NOT BODE WELL FOR FUTURE PRICE TRENDS. MOREOVER, AS OF JANUARY 1, ENERGY PRICES WERE HIKED AGAIN -- MODERATELY FOR DOMESTIC CONSUMERS BUT SUBSTANTIALLY FOR INDUSTRIAL USERS (19 PERCENT FOR ELECTRICITY, 20 PERCENT FOR GAS AND 11 PERCENT FOR INDUSTRIAL FUEL OIL). RISE IN THESE KEY INPUT PRICES WILL CERTAINLY EXERT UPWARD PRESSURE ON COSTS OF PRODUCTION AND HENCE ON ENTIRE PRICE STRUCTURE IN MONTHS AHEAD.

IN SUM, WE ARE DOUBTFUL THAT RISE OF CONSUMER PRICE INDEX IN COURSE OF 1975 CAN BE BROUGHT UNDER 10-11 PERCENT RANGE, EVEN IF SUCH EXOGENOUS FACTORS AS PRICES OF PRIMARY PRODUCTS AND FOREIGN EXCHANGE VALUE OF FRANC WERE TO CONTINUE TO BREAK IN FRANCE'S FAVOR. THIS PROJECTION COMPARES WITH GOVERNMENT'S OFT STATED OBJECTIVE OF AN 8 PERCENT INCREASE FOR YEAR AS A

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WHOLE, WITH PRICE RISES MODERATING IN MIDDLE OF YEAR
TO ANNUAL RATE OF ONLY 6 PERCENT.

5. BALANCE OF PAYMENTS. MONTHLY FOREIGN TRADE FIGURES
FOR LATTER PART OF 1974 SHOW REVERSAL OF PROGRESSIVE
DETERIORATION UNDERWAY BEFORE SUMMER VACATION PERIOD.
UNDOUBTEDLY IN ASSOCIATION WITH SLOWING-DOWN OF FRENCH
ECONOMIC GROWTH RATE, IMPORTS HAVE TENDED TO LEVEL OFF,
WHEREAS EARLIER IN YEAR THEY HAD BEEN CLIMBING RAPIDLY.
EXPORTS, ON THE OTHER HAND, HAVE REMAINED ON A HIGH
PLATEAU. THUS THANKS MAINLY TO RECENT EVOLUTION OF
IMPORTS, TRADE DEFICIT FOR 1974 AS A WHOLE WILL ALMOST
CERTAINLY BE UNDER \$5 BILLION (ON A BALANCE-OF-PAYMENTS
BASIS). PREVIOUSLY IT HAD BEEN FEARED THAT 1974 TRADE
BALANCE MIGHT BE IN THE RED BY \$6 BILLION OR MORE.
AFTER ADDITION OF DEFICIT ON CURRENT INVISIBLES AND
UNILATERAL TRANSFERS - WHICH HAS BEEN SHOWING TENDENCY
TO WORSEN - 1974 CURRENT ACCOUNT DEFICIT SHOULD TOTAL
ABOUT \$6.7 BILLION.

MUCH THE SAME PICTURE SEEMS LIKELY FOR TRADE ACCOUNT
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DURING FIRST HALF OF 1975. IMPORT DEMAND SHOULD TEND
TO BE SOFT IN FACE OF REDUCED PACE OF FRENCH ECONOMIC
GROWTH, WHEREAS SLUGGISH CONDITIONS PREVAILING IN A NUM-
BER OF FRANCE'S PRINCIPAL EXPORT MARKETS WILL LIMIT
POSSIBILITY OF EXPORT GAINS. AS A CONSEQUENCE, SEASONAL-
LY ADJUSTED TRADE DEFICIT WILL REMAIN AT VIRTUALLY SAME
LEVEL AS THAT REGISTERED SINCE PAYMENTS PROBLEM BECAME
ACUTE AT BEGINNING OF 1974.

BY CONTRAST, AN IMPROVEMENT IN TRADE ACCOUNT SHOULD
MANIFEST ITSELF IN LATTER PART OF CURRENT YEAR. EVEN
ALLOWING FOR SOME REVIVAL IN GROWTH OF IMPORTS -- AFTER
THEIR HAVING MARKED TIME FOR BETTER PART OF A YEAR --
TRADE DEFICIT FOR LAST SIX MONTHS OF 1975 SHOULD SHRINK,
AS EXPORTS EXPAND IN RESPONSE TO REVIVING DEMAND ABROAD,
WHILE FRENCH ECONOMY CONTINUES ON COURSE OF MODERATE
GROWTH ONLY. THIS RESULT WOULD BRING FRENCH GOVERNMENT
CLOSE TO ITS OBJECTIVE OF RESTORING TRADE BALANCE TO

EQUILIBRIUM RATE BY END OF 1975. HOWEVER, DURABILITY OF THE ACCOMPLISHMENT WOULD BE UNCERTAIN, FOR IT WOULD HAVE TAKEN PLACE IN A DEPRESSED ECONOMIC CLIMATE THAT, IN PERSPECTIVE OF FRENCH ECONOMIC PERFORMANCE OVER PAST 20 YEARS OR SO, DOES NOT SEEM SUSTAINABLE. MORE-OVER, BALANCE ON INVISIBLES AND UNILATERAL TRANSFERS IS LIKELY TO SHOW CONTINUING DETERIORATION, IF ONLY BECAUSE OF RISING BURDEN OF SERVICING BORROWINGS UNDERTAKEN TO FINANCE DEFICITS IN 1974 AND SUBSEQUENT YEARS. THUS FOR SECOND HALF OF 1975, DESPITE DROP OF MORE THAN 50 PERCENT IN TRADE DEFICIT, CURRENT ACCOUNT DEFICIT IS FORECAST TO FALL TO ONLY \$4.6 BILLION AT SEASONALLY ADJUSTED ANNUAL RATE, COMPARED TO \$6.5-7 BILLION LEVEL PREVAILING IN PRECEDING 18 MONTHS.

FRENCH BALANCE OF PAYMENTS
(\$ BILLIONS, ESTIMATES AND FORECASTS,
SEASONALLY ADJUSTED)

	1973	1974	1975
EXPORTS	35.9	46.1	54.1
IMPORTS	35.1	51.0	57.6
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TRADE BALANCE	0.8	-4.9	-3.5
SERVICES AND TRANSFERS	-1.5	-1.8	-2.3
CURRENT BALANCE	-0.7	-6.7	-5.8

	1973	1974	1975
	II	I	II
EXPORTS	19.2	21.7	24.4
IMPORTS	19.3	24.1	26.9
TRADE BALANCE	-0.1	-2.4	-2.5
SERVICES AND TRANSFERS	-0.8	-0.9	-0.9
CURRENT BALANCE	-0.9	-3.3	-3.4

5. IMPLICATIONS OF POSSIBLE POLICY MODIFICATIONS. FORECASTS DISCUSSED ABOVE ARE FOUNDED ON ASSUMPTION THAT CURRENT ECONOMIC POLICIES - CREDIT SQUEEZE AND TIGHT FISCAL POLICY - WILL BE MAINTAINED IN THEIR BROAD LINES

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WELL INTO 1975. IN CONSEQUENCE, EVEN IF THERE WERE TO BE A MAJOR POLICY SHIFT IN LATTER PART OF YEAR, THERE WOULD NOT BE TIME FOR IT TO HAVE ANY SUBSTANTIAL EFFECT ON EVOLUTION OF ECONOMY IN CURRENT YEAR. SPECIAL PROGRAMS MAY, OF COURSE, BE LAUNCHED FROM TIME TO TIME, PINPOINTED TO SECTORS IN PARTICULAR DISTRESS. AUTOMOBILE INDUSTRY HAS ALREADY BENEFITED FROM SUCH AN INITIATIVE, AND ASSISTANCE TO OTHER INDUSTRIES -- E.G., CONSTRUCTION - MAY FOLLOW. THESE SPECIFIC MEASURES WOULD, HOWEVER, BE DESIGNED PRECISELY TO DEFLECT STRONGEST PRESSURES FOR GENERAL POLICY REVISION.

NEVERTHELESS, AS WE HAVE INDICATED ABOVE, CURRENT FRENCH ECONOMIC SITUATION AND PROJECTED OUTLOOK FOR 1975 ARE IN MANY RESPECTS THE GLOOMIEST EVER EXPERIENCED BY A SUBSTANTIAL PART OF PRESENT FRENCH POPULATION. EVEN IF FIGURES STILL LOOK GOOD IN INTERNATIONAL COMPARISONS, THE GROWTH RATE IS THE LOWEST, AND THE UNEMPLOYMENT RATE THE HIGHEST, SINCE WORLD WAR II. THERE IS EVERY PROSPECT THAT SITUATION WILL WORSEN AS 1975 ADVANCES. PRICE INCREASES, WHILE BY NO

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MEANS A RECORD IN THIS INFLATION-PRONE COUNTRY, ARE NONETHELESS SUBSTANTIAL, AND ARE UNCHARACTERISTICALLY IN JUXTAPOSITION WITH RECESSIONARY TENDENCIES. THIS SOMBER CLIMATE IS MITIGATED ONLY BY THE CONTINUING RISE IN REAL WAGES, WHICH, EVEN WITH THE THIRD QUARTER'S DECLINE IN THE RATE OF INCREASE OF NOMINAL WAGES, STILL ADVANCED BY 2.7 PERCENT IN ANNUAL TERMS.

CURRENT ECONOMIC POLICY IS A MATTER OF MUCH PUBLIC CONTROVERSY AND ITS CHIEF ARCHITECT - ECONOMICS AND FINANCE MINISTER FOURCADE - A TARGET OF SEVERE AND GROWING CRITICISM. GOVERNMENT HAS SO FAR STOOD ITS GROUND. IT CANNOT BE EXCLUDED, HOWEVER, THAT PRESSURES WILL BECOME IRRESISTIBLE FOR EARLY LOOSENING OF STABILIZATION RESTRAINTS. KEY INDICATOR IN THIS RESPECT IS UNEMPLOYMENT. IF IT SHOULD CLIMB BEYOND OUR PROJECTED 4 PERCENT RANGE, STEPS TO REFLATE - FIRST OF ALL, AN EASIER MONETARY POLICY - WOULD QUICKLY MATERIALIZE. FRENCH POLICYMAKERS HAVE ALSO SUGGESTED THAT, IF NECESSARY TO SAFEGUARD LEVELS OF BUSINESS ACTIVITY AND EMPLOYMENT, THEY WOULD MAKE USE OF BUDGET SURPLUS.

UNLESS A DECISION FOR A MAJOR POLICY CHANGE WERE TAKEN WITHIN THE COMING WEEKS - AN UNLIKELY EVENTUALITY - IT WOULD PROBABLY NOT HAVE MUCH EFFECT ON THE 1975 ECONOMIC OUTLOOK. AT BEST, THE POLICY EASING WOULD RAISE marginally the rate of growth in second half-year and perhaps engender some improvement on employment front. WHATEVER EFFECTS THE SHIFT MIGHT HAVE ON PRICES, WAGES AND BALANCE OF PAYMENTS WOULD PROBABLY NOT MATERIALIZE UNTIL AFTER END OF 1975.
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